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IN THE  
**Supreme Court of the United States**  
October Term, 1976

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No. 75-1853

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BOISE CASCADE CORPORATION AND SUBSIDIARY COMPANIES,  
*Petitioner,*

*v.*

THE UNITED STATES

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**PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF CLAIMS**

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**SUPPLEMENTAL BRIEF RE INTERVENING  
MATTER**

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**Supplemental Brief re Intervening Matter**

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This Supplement to the Petition for a Writ of Certiorari to the United States Court of Claims is submitted for the reason that the Commissioner of Internal Revenue has, since the filing of the original Petition, issued proposed regulations in which the Commissioner of Internal Revenue necessarily admits that the proper interpretation of the Internal Revenue Code is just the opposite of that found by the United States Court of Claims in reaching its decision in *General Foods Corporation v. The United States*, 530 F. 2d 923 (Ct. Cl., 1976) upon which the Court relied in holding against Boise Cascade Corporation and Subsidiary Companies.

As pointed out in the Petition for a Writ of Certiorari, the issue before the Court of Claims was whether gains attributable to original issue discount on evidences of indebtedness issued by corporations after December 31, 1954 and before May 28, 1969 and held by the taxpayer as capital assets for periods of not more than 6 months are taxable as short-term capital gains.

The resolution of this issue turns on the intention of Congress in adopting section 1232, as originally enacted in the Internal Revenue Code of 1954, P.L. 591, 68A Stat. 3. This section provided in part as follows:

**"SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.**

(a) **GENERAL RULE.**—For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—

(1) **RETIREMENT.**—Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

**"(2) SALE OR EXCHANGE.**—

(A) **GENERAL RULE.**—Except as provided in subparagraph (B), upon sale or exchange of bonds or other evidences of indebtedness issued after December 31, 1954, held by the taxpayer more than 6 months, any gain realized which does not exceed an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidences of

indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered as gain from the sale or exchange of property, which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.

• • • • •

**"(b) DEFINITIONS.**—

(1) **ORIGINAL ISSUE DISCOUNT.**—For purposes of subsection (a), the term 'original issue discount' means the difference between the issue price and the stated redemption price at maturity. If the original issue discount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity, then the issue discount shall be considered to be zero. For purposes of this paragraph, the term 'stated redemption price at maturity' means the amount fixed by the last modification of the purchase agreement and includes dividends payable at that time."

Section 1232, as amended by the Tax Reform Act of 1969, P. L. 91-172, 83 Stat. 487 provides in pertinent part as follows:

**"SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.**

(a) **GENERAL RULE.**

• • • • •

(2) **SALE OR EXCHANGE.**

• • • • •

**"(B) CORPORATE BONDS ISSUED ON OR BEFORE MAY 27, 1969, AND GOVERNMENT BONDS.**—Except as provided in subparagraph (C), on the sale or exchange of bonds or other evidences of indebtedness issued by a government or political subdivision thereof after December 31, 1954, or by a corporation after

December 31, 1954, and on or before May 27, 1969, held by the taxpayer more than 6 months, any gain realized which does not exceed—

(i) an amount equal to the original issue discount (as defined in subsection (b)), or

(ii) if at the time of original issue there was no intention to call the bond or other evidence of indebtedness before maturity, an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidence of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity,

shall be considered as gain from the sale or exchange of property which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.”

The statutory language at issue is the clause “\* \* \* held by the taxpayer more than 6 months” at section 1232(a)(2)(A) of the Internal Revenue Code of 1954 as originally enacted and section 1232(a)(2)(B) of the Internal Revenue Code of 1954 as amended by the Tax Reform Act of 1969. What did Congress intend to be the treatment of gains attributable to original issue discount on evidences of indebtedness held for not more than 6 months?

On July 9, 1976, the Commissioner of Internal Revenue proposed regulations applicable to the treatment of the realization of gains attributable to original issue discount on evidences of indebtedness held by nonresident aliens and foreign corporations for not more than 6 months. These proposed regulations were published in the Federal Register, Vol. 41, No. 134 on July 12, 1976, a copy of which is attached as Appendix A. These proposed regulations concern Internal Revenue Code section 871(a) which provides:

“SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

(a) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

(1) INCOME OTHER THAN CAPITAL GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

(A) interest (other than original issue discount as defined in section 1232(b)), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

• • • • •

“(C) in the case of—

(i) bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which under section 1232 (a)(2)(B) are considered as gain from the sale or exchange of property which is not a capital asset, and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which would be so considered but for the fact the obligations were issued after May 27, 1969,\*

• • • • •”

It will be noted that section 871(a)(1)(C)(i) quoted above is made dependent by cross-reference on section 1232(a)(2)(B). This is the provision of section 1232 as amended by the Tax Reform Act of 1969 quoted at page 3 above. Such section in turn continues the language at issue before the United States Court of Claims in the case of *Boise Cascade*

\* The cut off dates of September 28, 1965 and May 27, 1969 refer respectively to the dates set forth in the Internal Revenue Code to which the statutory predecessor of section 871(a)(1)(C)(i) and section 1232 (a)(2)(B) first applied.



*Corporation and Subsidiary Companies v. The United States* which was contained in section 1232(a)(2)(A) as originally adopted *i.e.*, a provision for treatment of original issue discount on evidences of indebtedness "held by the taxpayer more than 6 months".

The issue before the Court of Claims was the proper interpretation of the Internal Revenue Code with respect to gains attributable to original issue discount on evidences of indebtedness which were not "held by the taxpayer more than 6 months". The Court of Claims held in the case of *General Foods Corporation v. The United States, supra* that such gain was to be treated as ordinary income and not as short-term capital gain and relied on that decision in reaching the same conclusion in *Boise Cascade Corporation and Subsidiary Companies v. The United States*.

Exactly the same statutory language was recently considered by the Commissioner of Internal Revenue in proposing regulations applicable to nonresident aliens and to foreign corporations published in the Federal Register on July 12, 1976. Proposed Regulations 1.871-7 to the extent relevant provide as follows:

"(c) *Other income and gains*—(1) *Items subject to tax.* The tax of 30 percent imposed by section 871(a)(1) also applies to the following gains received during the taxable year from sources within the United States:

• • • • •  
 "(ii) In the case of—

(A) Bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which, by applying the principles of section 1232(a)(2)(B), are considered as gain from the sale or exchange of property which is not a capital asset and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which, by applying the principles of section

1232(a)(2)(B), would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact the obligations were issued after May 27, 1969.

• • • • •  
 "(2) *Nonapplication of 183-day rule.* The provisions of section 871(a)(2), relating to gains from the sale or exchange of capital assets, and paragraph (d)(2) of this section do not apply to the gains described in this paragraph; as a consequence, the taxpayer receiving gains described in paragraph (c)(1) of this section during a taxable year is subject to the tax of 30 percent thereon without regard to the 183-day rule contained in such provisions.

• • • • •  
 "(4) *Special rules applicable to original issue discount*—

• • • • •  
 "(ii) *Sale, exchange, or retirement of bond issued before April 1, 1972.* Section 871(a)(1)(C)(i) and paragraph (c)(1)(ii)(A) of this section apply only to amounts derived from the sale, exchange, or retirement of a bond or other evidence of indebtedness, whether or not interest-bearing, which was issued after September 28, 1965, and before April 1, 1972, and which, at the time of such sale, exchange, or retirement, had been held by the taxpayer more than 6 months. In applying section 871(a)(1)(C)(i), the provisions of section 1232(a)(2)(B) are deemed to apply to bonds or other evidences of indebtedness which were issued by a corporation after May 27, 1969, and before April 1, 1972."

As read in context proposed Regulations 1.871-7(c)(1)(ii)(A) and (4)(ii) (the second and fourth paragraphs or partial paragraphs quoted above) provide that gain attributable to original issue discount on obligations held by the taxpayer for not more than 6 months which were issued after

September 28, 1965 and before April 1, 1972 and to which the principles of section 1232(a)(2)(B) are applicable shall not be treated as ordinary income. Proposed Regulations section 1.871-7(c)(2) (the third paragraph or partial paragraph quoted above) provides that such gain shall be treated as capital gain. The statutory language being interpreted by the Commissioner of Internal Revenue is exactly the same as that which was considered by the United States Court of Claims in *General Foods Corporation v. The United States* and in *Boise Cascade Corporation and Subsidiary Companies v. The United States*.

As pointed out in the Petition for a Writ of Certiorari to the United States Court of Claims to which this submission is a Supplement, the United States Court of Claims in *Boise Cascade Corporation and Subsidiary Companies v. The United States* reached a decision directly contrary to the expressed intention of Congress concerning the statutory language that continues to be a part of section 1232 of the Internal Revenue Code of 1954. This decision has created confusion on the part of taxpayers which will be further compounded by the proposed regulations of the Commissioner of Internal Revenue which are contrary to the decision of the United States Court of Claims on exactly the same statutory language. The proposed regulations were issued in the form adopted for the reason that the Commissioner of Internal Revenue necessarily recognized that the United States Court of Claims had incorrectly failed to follow the clearly expressed intention of Congress.

### Conclusion

The proposed regulations issued by the Commissioner of Internal Revenue subsequent to the filing of a Petition for a Writ of Certiorari in this case necessarily indicate the acceptance by the Commissioner that the decision of the United States Court of Claims was erroneous for such decision is in direct conflict with the Commissioner's proposed regulations concerning the same provision of section 1232 of the Internal Revenue Code, as adopted by cross-reference in section 871 of the Code. The proposed regulations are further evidence that this erroneous decision of the Court of Claims will create confusion on the part of taxpayers attempting to comply with the Internal Revenue Code for the reason that the decision cannot even be applied by the Commissioner of Internal Revenue. The Petition for the Writ of Certiorari should be granted.

Respectfully submitted,

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**APPENDIX A**

**FEDERAL REGISTER**

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Internal Revenue Service

[26 CFR Parts 1, 31]

**INCOME AND EMPLOYMENT TAXES**

**Treatment of Original Issue Discount Realized by Nonresident Alien Individuals or Foreign Corporations**

Notice is hereby given that the regulations set forth in tentative form in the attached appendix are proposed to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury or his delegate. Prior to the final adoption of such regulations, consideration will be given to any comments pertaining thereto which are submitted in writing (preferably six copies) to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224, by August 26, 1976. Pursuant to 26 CFR 601.601(b), designations of material as confidential or not to be disclosed, contained in such comments, will not be accepted. Thus, persons submitting written comments should not include therein material that they consider to be confidential or inappropriate for disclosure to the public. It will be presumed by the Internal Revenue Service that every written comment submitted to it in response to this notice of proposed rule making is intended by the person submitting it to be subject in its entirety to public inspection and copying in accordance with the procedures of 26 CFR 601.702(d)(9).

Any person submitting written comments who desires an opportunity to comment orally at a public hearing on



these proposed regulations should submit a request in writing, to the Commissioner by August 26, 1976. In such case, a public hearing will be held, and notice of the time, place, and date will be published in a subsequent issue of the FEDERAL REGISTER, unless the person or persons who have requested a hearing withdraw their requests for a hearing before notice of the hearing has been filed with the Office of the Federal Register. The proposed regulations are to be issued under the authority contained in sections 1441(c)(8) (85 Stat. 527; 26 U.S.C. 1441(c)(8)) and 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

DONALD C. ALEXANDER,  
*Commissioner of Internal Revenue.*

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Employment Tax Regulations (26 CFR Part 31). The Income Tax Regulations are being amended in order to conform such regulations to the provisions of section 313 of the Revenue Act of 1971 (Pub. L. 92-178, 85 Stat. 526), relating to the taxation of original issue discount to nonresident alien individuals and foreign corporations. The Employment Tax Regulations are being amended to make technical corrections and to provide a rule for withholding on remuneration for services of nonresident performed in a previous taxable year.

The Tax Reform Act of 1969 (Pub. L. 91-172, 83 Stat. 487) changed previous law to provide generally that original issue discount on corporate obligations would be currently taxed as ordinary income as it ratably accrues instead of being taxed at the time of the sale, exchange, or retirement of the obligation. At the time of the passage of the Tax

Reform Act of 1969, the law provided that nonresident alien individuals and foreign corporations were subject to a 30-percent tax on original issue discount received from the sale, exchange, or retirement of a bond issued after September 28, 1965, as determined under the principles of section 1232 of the Internal Revenue Code of 1954. This rule on bonds issued after September 28, 1965, had been added by the Foreign Investors Tax Act of 1966 (Pub. L. 89-809, 80 Stat. 1539). The law relating to the taxation of original issue discount attributable to obligations held by nonresident aliens or foreign corporations was not changed by the 1969 Act to reflect the newly enacted ratable inclusion provisions. This caused confusion with respect to the treatment of original issue discount of nonresident alien individuals and foreign corporations.

Section 313 of the Revenue Act of 1971 amended sections 871 and 881 effective for taxable years beginning after December 31, 1966; it also amended sections 1441 and 1442 effective with respect to payments occurring after March 31, 1972. Under these amendments the tax imposed by the 1966 Act is retained for obligations issued after September 28, 1965, and before April 1, 1972, but new rules of taxation are adopted for obligations issued after March 31, 1972, including rules for ratable taxation of original issue discount on obligations on which stated interest is also payable. The amendments to sections 1441 and 1442 give the Treasury special authority to provide for the application of the withholding tax to original issue discount.

Under the 1971 Act original issue discount on non-interest bearing obligations issued after March 31, 1972, with an original maturity of more than 6 months is to be taxed at 30 percent to the foreign holder only upon sale, exchange, or retirement of the obligation. However, in the case of such obligations issued after March 31, 1972, which are interest-bearing, both the interest payment and a



ratable portion of the original issue discount are to be taxed to the foreign holder at the rate of 30 percent at the time of the interest payment. The 1971 Act also excluded from the 30-percent tax original issue discount on such obligations issued after March 31, 1972, with original maturities of 6 months or less and held by nonresident alien individuals or foreign corporations. The conference report noted, however, that the amendment was not intended to imply how bonds held for 6 months or less are treated for tax purposes when held by United States persons.

The proposed amendments to the Income Tax Regulations provide a method for the determination of the amount of tax which will be imposed on nonresident alien individuals, foreign partnerships, and foreign corporations and the amount and manner of withholding of the tax at source.

Section 1.871-7 of the Income Tax Regulations provides rules for determination of the amount of tax imposed on nonresident alien individuals not engaged in a U.S. trade or business. Section 1.871-7 has been amended in the accompanying proposed regulations by the addition of a new paragraph (c)(1)(ii), describing the amounts of original issue discount which are taxable under section 871(a)(1)(C), and a new paragraph (c)(4), describing in detail the manner of applying section 871(a)(1)(C). The new rules make clear that section 871(a)(1)(C) applies to amounts of original issue discount whether or not the obligation is a capital asset in the hands of the taxpayer and whether or not the obligation was issued by a government or political subdivision thereof, or by a corporation or any other person. Accordingly, § 1.871-7(b) has been amended in the accompanying proposed regulations to specifically exclude from the term "interest" original issue discount (as defined in section 1232(b)) derived from bonds, notes, or other evidences of indebtedness whether or not they are

capital assets in the hands of the taxpayer and whether or not they were issued by a government or political subdivision thereof, of [sic] by a corporation or any other person. Corresponding amendments have also been made to § 1.881-2 of the Income Tax Regulations which applies to taxation of foreign corporations not engaged in trade or business in the United States.

Section 1.1441-2 of the Income Tax Regulations, which provides rules for determining the items of income of foreign persons which are subject to withholding of tax at 30 percent, is amended to exclude original issue discount (as described in § 1.871-7(b)(2)) from the term "interest" and specifically include original issue discount, subject to the rules of new § 1.1441-3(c)(6), in the definition of "other income" subject to withholding.

Section 1.1441-3 of the Income Tax Regulations has been amended by the addition of a new paragraph (c)(6) which gives guidance to withholding agents with respect to the mechanics of withholding on original issue discount. Withholding will be required whether the evidence of indebtedness is a capital asset in the hands of the taxpayer or whether it was held by the taxpayer more than 6 months.

Withholding will also be required whether the evidence of indebtedness was issued by a government or political subdivision thereof, or by a corporation or any other person. However, withholding with respect to obligations not issued by a government or political subdivision thereof, or by a corporation will only be required for payments occurring after the 30th day following publication of the Treasury decision.

By TIR-877, dated December 27, 1966, the Internal Revenue Service announced that, until regulations concerning the withholding of tax under section 1441 or section 1442 on amounts subject [sic] to tax under section 871(a)(1)(C) or section 881(a)(3), as added by the 1966 Act, are adopted,

only the original issuers of the bond or other evidence of indebtedness would be required to withhold the tax. This position was also adopted in Rev. Rul. 68-333, 1968-1 C.B. 390.

Proposed paragraphs (c)(6)(i)(A) and (B) provide for withholding with respect to evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, which are subject to tax under section 871(a)(1)(C)(i). Under proposed paragraph (c)(6)(i)(A) only original issuers are required to withhold in the case of payments occurring before the 31st day following publication of the Treasury decision in this case. This position is consistent with TIR-877 and Rev. Rul. 68-333. Under proposed paragraph (c)(6)(i)(B) all United States persons are required to withhold in the case of payments occurring after the 30th day following publication of the Treasury decision in this case. Withholding in the future is restricted to United States persons because of the administrative difficulty of enforcing withholding with respect to sales and exchanges between foreign persons.

Proposed paragraph (c)(6)(i)(C) provides for withholding with respect to evidences of indebtedness issued after March 31, 1972, which are subject to tax under section 871(a)(1)(C)(ii). Under proposed paragraph (c)(6)(i)(C) all United States persons are required to withhold in the case of payments occurring after March 31, 1972. Again, withholding is restricted to United States persons because of the administrative difficulty of enforcing withholding with respect to sales and exchanges between foreign persons. Payment of the tax under section 871(a)(1)(C) is required in all cases by the filing of a return by the taxpayer. Corresponding rules would also apply in the case of original issue discount to which section 881(a)(3) applies.

The amendments of §§ 1.871-1 and 1.1441-3(e) are technical in nature.

In view of the foregoing considerations, the Income Tax Regulations and the Employment Tax Regulations are hereby amended as follows:

#### INCOME TAX REGULATIONS

PARAGRAPH 1. Section 1.871 is amended by revising section 871(a)(1) (A) and (C) and the historical note to read as follows:

§ 1.871 Statutory provisions; tax on nonresident alien individuals (after amendment by Foreign Investors Tax Act of 1966).

SEC. 871. *Tax on nonresident alien individuals—(a) Income not connected with United States business—30 percent tax—(1) Income other than capital gains. . . .*

(A) Interest (other than original issue discount as defined in section 1232 (b)), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

• • •

(C) In the case of—

(i) Bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which under section 1232(a)(2)(B) are considered as gain from the sale or exchange of property which is not a capital asset, and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which would be so considered but for the fact the obligations were issued after May 27, 1969,

(ii) Bonds or other evidences of indebtedness issued after March 31, 1972, and payable more than 6 months from the date of original issue (without regard to the period held by



the taxpayer), amounts which under section 1232(a)(2)(B) would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact such obligations were issued after May 27, 1969, and

(iii) The payment of interest on an obligation described in clause (ii), an amount equal to the original issue discount (but not in excess of such interest less the tax imposed by subparagraph (A) thereon) accrued on such obligation since the last payment of interest thereon, and

• • •

[Sec. 871 as amended by secs. 40(a) and 41(a), Technical Amendments Act 1958 (72 Stat. 1638, 1639); sec. 2(b), Act of April 22, 1960 (Pub. Law 86-437, 74 Stat. 79); sec. 110(b), Mutual Educational and Cultural Exchange Act 1961 (75 Stat. 535); secs. 113(b) and 201(d)(12), Rev. Act 1964 (78 Stat. 24, 32); sec. 103(a), Foreign Investors Tax Act 1966 (80 Stat. 1547); sec. 313 (a) and (b), Rev. Act 1971 (85 Stat. 526)]

PAR. 2. Section 1.871-1 is amended by revising the caption of paragraph (b) and redesignating paragraph (d) as paragraph (c), as follows:

§ 1.871-1 Classification and manner of taxing alien individuals.

• • •

(b) *Nonresident alien individuals.* • • •

(c) *Effective date.* • • •

PAR. 3. Section 1.871-7 is amended by revising paragraphs (b) and (c) to read as follows:

§ 1.871-7 Taxation of nonresident alien individuals not engaged in U.S. business.

• • •

(b) *Fixed or determinable annual or periodical income—*  
 (1) *In general.* The tax of 30 percent imposed by section 871(a)(1) applies to the gross amount received from sources within the United States as fixed or determinable annual or periodical gains, profits, or income. Specific items of fixed [*sic*] or determinable annual or periodical income are enumerated in section 871(a)(1)(A) as interest (other than original issue discount described in paragraph (b)(2) of this section), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments, but other items of fixed or determinable annual or periodical gains, profits, or income are also subject to the tax, as, for instance, royalties, including royalties for the use of patents, copyrights, secret processes and formulas, and other like property. As to the determination of fixed or determinable annual or periodical income, see paragraph (a) of § 1.1441-2. For special rules treating gain on the disposition of section 306 stock as fixed or determinable annual or periodical income for purposes of section 871(a), see section 306(f) and paragraph (h) of § 1.306-3.

(2) *Original issue discount.* As used in paragraph (b)(1) of this section, the term "original issue discount" means original issue discount within the meaning of section 1232(b) on any bond, debenture, note, certificate, or other evidence of indebtedness. For this purpose, it is immaterial (i) whether the evidence of indebtedness is a capital asset in the hands of the taxpayer within the meaning of section 1221, (ii) whether it was held by the taxpayer more than 6 months, or (iii) whether it was issued by a government or political subdivision thereof, or by a corporation or any other person.

(c) *Other income and gains—*(1) *Items subject to tax.* The tax of 30 percent imposed by section 871(a)(1) also applies to the following gains received during the taxable year from sources within the United States:



(i) Gains described in section 402(a)(2), relating to the treatment of total distributions from certain employees' trusts; section 403(a)(2), relating to treatment of certain payments under certain employee annuity plans; and section 631 (b) or (c), relating to treatment of gain on the disposal of timber, coal, or iron ore with a retained economic interest;

(ii) In the case of—

(A) Bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which, by applying the principles of section 1232(a)(2)(B), are considered as gain from the sale or exchange of property which is not a capital asset and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which, by applying the principles of section 1232(a)(2)(B), would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact the obligations were issued after May 27, 1969.

(B) Bonds or other evidences of indebtedness issued after March 31, 1972, which are payable more than 6 months from the date of original issue (without regard to the period held by the taxpayer), amounts which, by applying the principles of section 1232(a)(2)(B), are considered as gain from the sale or exchange of property which is not a capital asset and, in the case of corporate obligations, amounts which, by applying the principles of section 1232(a)(2)(B), would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact such obligations were issued after May 27, 1969, and

(C) The payment of interest on an obligation described in paragraph (c)(1)(ii)(B) of this section, an amount equal to the original issue discount accrued on such obligation since the last payment of interest thereon, except that

the tax imposed by reason of this paragraph (c)(1)(ii)(C) may not exceed the amount of such interest payment less the tax imposed thereon under the rules of paragraph (b) of this section;

(iii) Gains on transfers described in section 1235, relating to certain transfers of patent rights, made on or before October 4, 1966; and

(iv) Gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, or other like property, or of any interest in any such property, to the extent the gains are from payments (whether in a lump sum or in installments) which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated under 871(e) and § 1.871-11 as being so contingent.

(2) *Nonapplication of 183-day rule.* The provisions of section 871(a)(2), relating to gains from the sale or exchange of capital assets, and paragraph (d)(2) of this section do not apply to the gains described in this paragraph; as a consequence, the taxpayer receiving gains described in paragraph (c)(1) of this section during a taxable year is subject to the tax of 30 percent thereon without regard to the 183-day rule contained in such provisions.

(3) *Determination of amount of gain.* The tax of 30 percent imposed upon the gains described in paragraph (c)(1) of this section applies to the full amount of the gains and is determined (i) without regard to the alternative tax imposed by section 1201(b) upon the excess of the net long-term capital gain over the net short-term capital loss; (ii) without regard to the deduction allowed by section 1202 in respect of capital gains; (iii) without regard to section 1231, relating to property used in the trade or business

and involuntary conversions; and (iv) whether or not any property from which the gains are derived is a capital asset in the hands of the taxpayer.

(4) *Special rules applicable to original issue discount—*

(i) *In general.* Section 871(a)(1)(C) and paragraph (c)(1)(ii) of this section apply, subject to the other limitations prescribed therein and in this paragraph (c)(4), to all bonds or other evidences of indebtedness which are issued at a discount within the meaning of paragraph (b)(2) of this section. Thus, in applying section 871(a)(1)(C), the provisions of section 1232(a)(2)(B) are deemed to apply to assets which are not capital assets, to obligations which are not held by the taxpayer for more than 6 months, and to obligations not issued by a corporation or by a government or political subdivision thereof.

(ii) *Sale, exchange, or retirement of bond issued before April 1, 1972.* Section 871(a)(1)(C)(i) and paragraph (c)(1)(ii)(A) of this section apply only to amounts derived from the sale, exchange, or retirement of a bond or other evidence of indebtedness, whether or not interest-bearing, which was issued after September 28, 1965, and before April 1, 1972, and which, at the time of such sale, exchange, or retirement, had been held by the taxpayer more than 6 months. In applying section 871(a)(1)(C)(i), the provisions of section 1232(a)(2)(B) are deemed to apply to bonds or other evidences of indebtedness which were issued by a corporation after May 27, 1969, and before April 1, 1972.

(iii) *Sales, exchange, or retirement of bond issued after March 31, 1972.* Section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section apply only to amounts derived from the sale, exchange, or retirement of a bond or other evidence of indebtedness, whether or not interest-bearing and whether or not held by the taxpayer more than 6

months, which was issued after March 31, 1972, and is payable more than 6 months from the date of original issue. In applying section 871(a)(1)(C)(ii), the provisions of section 1232(a)(2)(B) are deemed to apply to bonds or other evidences of indebtedness which, at the time of the sale, exchange, or retirement, had been held by the taxpayer not more than 6 months and to bonds or other evidences of indebtedness which were issued by a corporation after May 27, 1969. Pursuant to section 1232(a)(2)(D) and § 1.1232-3(e), section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section do not apply to any amount previously includible in gross income. Thus, for example, any amount treated under paragraph (c)(4)(v) of this section as included in gross income in respect of original issue discount on which tax has been imposed under section 871(a)(1)(C)(iii) and paragraph (c)(1)(ii)(C) of this section at the time of an interest payment on an obligation shall not again be subject to tax under section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section when such obligation is sold, exchanged, or retired.

(iv) *Interest payments on bonds issued after March 31, 1972.* Section 871(a)(1)(C)(iii) and paragraph (c)(1)(ii)(C) of this section apply only when an interest payment is received on an interest-bearing bond or other evidence of indebtedness to which section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section apply. In addition to the 30-percent tax imposed on such interest under section 871(a)(1)(A) and paragraph (b) of this section, an additional 30-percent tax is imposed under section 871(a)(1)(C)(iii) and paragraph (c)(1)(ii)(C) of this section on the original issue discount accrued on such bond or other evidence of indebtedness since the last payment of interest thereon, as determined under paragraph (c)(4)(vi) of this section, except that such additional



tax may not exceed the amount of the interest payment less the 30-percent tax imposed on such interest under section 871 (a) (1) (A) and paragraph (b) of this section.

(v) *Treatment of discount as includible in gross income.*

(A) For purposes of applying paragraph (c) (4) (iii) of this section with respect to any bond or other evidence of indebtedness, an amount shall be treated as having been included in gross income which is equal to the amount obtained by dividing the amount of the additional 30-percent tax imposed under section 871 (a) (1) (C) (iii) and paragraph (c) (1) (ii) (C) of this section on the accrued original issue discount on such bond or other evidence of indebtedness by 30 percent. If the additional 30-percent tax on such accrued original issue discount is reduced by an income tax convention to which the United States is a party, the amount which shall be treated as having been included in gross income shall be the amount of such reduced additional tax divided by such reduced rate of tax. If no tax is imposed under section 871 (a) (1) (C) (iii) and paragraph (c) (1) (ii) (C) on the accrued original issue discount by reason of an exemption from tax under an income tax convention to which the United States is a party, the full amount of the accrued original issue discount which is so exempt from tax shall be treated as having been included in gross income.

(B) Pursuant to the principles of section 1232(a) (3) (E) and § 1.1232-3A(c), the basis of the bond or other evidence of indebtedness in the hands of the holder thereof shall be increased by an amount with respect to such bond or other evidence of indebtedness which is treated as having been included in gross income pursuant to this paragraph (c) (4) (v).

(vi) *Accrual [sic] of original issue discount.* For purposes of paragraph (c) (4) (iv) of this section, the original issue discount accrued on a bond or other evidence of indebted-

ness since the last payment of interest is an amount equal to the ratable monthly portion of original issue discount, determined by applying the principles of section 1232(a) (3) (A) and § 1.1232-3A(a) (2), multiplied by the sum of the number of complete months and any fractional part of a month occurring since the later of (A) the last payment of interest on the bond or other evidence of indebtedness or (B) the day on which the taxpayer purchased (within the meaning of § 1.1232-3A(a) (4)) such bond or other evidence of indebtedness.

(vii) *Illustrations.* The application of this paragraph (c) (4) may be illustrated by the following examples:

*Example (1).* On January 1, 1973, R, a nonresident alien individual using the calendar year as the taxable year and the cash receipts and disbursements method of accounting, purchases at original issue, for cash of \$7,600, M Corporation's 10-year, 5-percent bond which has a stated redemption price of \$10,000 and an original issue date of January 1, 1973. Under the terms of the bond M is to make interest payments of \$250 on June 30 and December 31 of each year. On July 1, 1973, R receives his first interest payment of \$250, and tax of \$75 ( $\$250 \times 30\%$ ) is imposed thereon under section 871 (a) (1) (A) and paragraph (b) of this section. By applying the principles of section 1232(a) (3) (A) the ratable monthly portion of original issue discount is \$20 ( $[\$10,000 - \$7,600] \div 120$ ), and the amount accrued from the date of purchase is \$120 ( $\$20 \times 6$ ). The tax imposed under section 871(a) (1) (C) (iii) and paragraph (c) (1) (ii) (C) of this section is \$36 ( $\$120 \times 30\%$ ), but not to exceed \$175 ( $\$250 - \$75$ ). Accordingly, a total tax of \$111 ( $\$75 + \$36$ ) is imposed under section 871(a) (1) (A) and (C) (iii) upon the receipt of interest by R.



*Example (2).* Assume the same facts as in example (1). Assume further that on December 31, 1973, M makes an interest payment of only \$40. On this \$40 payment of interest a tax of \$12 ( $\$40 \times 30\%$ ) is imposed under section 871(a)(1)(A) and paragraph (b) of this section. By applying the principles of section 1232(a)(3)(A), the ratable monthly portion of original issue discount is \$20, and the amount accrued from the last payment of interest on June 30, 1973, is \$120 ( $\$20 \times 6$ ). The tax imposed under section 871(a)(1)(C)(iii) and paragraph (c)(1)(ii)(C) of this section is \$36 ( $\$120 \times 30\%$ ), but not to exceed \$28 ( $\$40 - \$12$ ). Accordingly, a total tax of \$40 ( $\$12 + \$28$ ) is imposed under section 871(a)(1)(A) and (C)(iii) upon the receipt of interest by R. The amount of original issue discount which is treated as included in R's gross income by reason of the interest payment on December 31, 1973, is \$93.33 ( $\$28 \div 30\%$ ). The \$26.67 balance of the original issue discount ( $\$120 - \$93.33$ ) will be subject to tax under section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section when the M bond is sold, exchanged, or retired.

*Example (3).* (a) Assume the same facts, as in example (2). Assume further that on July 1, 1974, M makes an interest payment of \$250 to R and that immediately thereafter R sells the bond to a U.S. citizen for \$8,000. At no time during 1974 is R present in the United States. The assumption is also made that, at the time of original issue, there was no intention to call the bond before maturity. On this \$250 payment of interest a tax of \$75 ( $\$250 \times 30\%$ ) is imposed under section 871(a)(1)(A) and paragraph (b) of this section. By applying the principles of section 1232(a)(3)(A), the ratable monthly portion of original issue discount is \$20, and the amount accrued from the last payment of interest on December 31, 1973, is \$120 ( $\$20 \times 6$ ). The tax imposed in 1974 under section 871(a)(1)(C)(iii) and paragraph (c)(1)(ii)(C) of this section is \$36 ( $\$120 \times 30\%$ ), but not to exceed \$175 ( $\$250 - \$75$ ).

(b) The bond was held by R for 18 full months before it was sold. The number of complete months from the date of issue to date of maturity is 120 (10 years). The original issue discount on the bond is \$2,400 ( $\$10,000$  less \$7,600), as determined under section 1232(b). Accordingly, the proportionate part of the original issue discount attributable to the period of R's ownership is \$360 ( $\$2,400 \times 18/120$ ), which is the maximum amount includible by R as ordinary income. On the sale of the bond R realizes total gain of \$66.67 ( $\$8,000 - [\$7,600 + \$120 + \$93.33 + \$120]$ ). Of this amount, \$26.67 ( $\$360 - [\$120 + \$93.33 + \$120]$ ) is subject to tax under section 871(a)(1)(C)(ii) and paragraph (c)(1)(ii)(B) of this section [sic], and the tax thereon under such provisions is \$8 ( $\$26.67 \times 30\%$ ).

(c) Accordingly [sic], in 1974 a total tax of \$119 ( $\$75 + \$36 + \$8$ ) is imposed under section 871(a)(1)(A) and (C)(ii) and (iii) upon the interest, accrued original issue discount, and gain realized by R from the M bond. The remaining gain of \$40 ( $\$66.67 - \$26.67$ ) is treated as long-term capital gain which is not subject to tax under section 871(a)(1).

. . . . .

PAR. 4. Section 1.881 is amended by revising section 881(a)(1) and (3) and the historical note to read as follows:

§ 1.881 Statutory provisions; tax on income of foreign corporations not connected with United States business.

SEC. 881 *Tax on income of foreign corporations not connected with United States business—(a) Imposition of tax.*

. . . . .

(1) Interest (other than original issue discount as defined in section 1232(b)), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

. . . . .

## (3) In the case of—

(A) Bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which under section 1232(a)(2)(B) are considered as gain from the sale or exchange of property which is not a capital asset, and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which would be so considered but for the fact the obligations were issued after May 27, 1969.

(B) Bonds or other evidences of indebtedness issued after March 31, 1972, and payable more than 6 months from the date of original issue (without regard to the period held by the taxpayer), amounts which under section 1232(a)(2)(B) would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact such obligations were issued after May 27, 1969, and

(C) The payment of interest on an obligation described in subparagraph (B), an amount equal to the original issue discount (but not in excess of such interest less the tax imposed by paragraph (1) thereon) accrued on such obligation since the last payment of interest thereon, and

. . . . .

[Sec. 881 as amended by sec. 104(a), Foreign Investors Tax Act 1966 (80 Stat. 1555); sec. 313(a) and (c), Rev. Act 1971 (85 Stat. 526)]

PAR. 5. Section 1.881-2 is amended by revising paragraphs (b) and (c) to read as follows:

§ 1.881-2 Taxation of foreign corporations not engaged in U.S. business.

. . . . .

(b) *Fixed or determinable annual or periodical income—*

(1) *In general.* The tax of 30 percent imposed by section 881(a) applies to the gross amount received from sources

within the United States as fixed or determinable annual or periodical gains, profits, or income. Specific items of fixed or determinable annual or periodical income are enumerated in section 881(a)(1) as interest (other than original issue discount described in paragraph (b)(2) of this section), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments, but other items of fixed or determinable annual or periodical gains, profits, or income are also subject to the tax, as, for instance, royalties, including royalties for the use of patents, copyrights, secret processes and formulas, and other like property. As to the determination of fixed or determinable annual or periodical income, see paragraph (a) of § 1.1441-2. For special rules treating gain on the disposition of section 306 stock as fixed or determinable annual or periodical income for purposes of section 881(a), see section 306(f) and paragraph (h) of § 1.306-3.

(2) *Original issue discount.* As used in paragraph (b)(1) of this section, the term “original issue discount” means original issue discount within the meaning of section 1232(b) on any bond, debenture, note, certificate, or other evidence of indebtedness. For this purpose, it is immaterial (i) whether the evidence of indebtedness is a capital asset in the hands of the taxpayer within the meaning of section 1221, (ii) whether it was held by the taxpayer more than 6 months, or (iii) whether it was issued by a government or political subdivision thereof, or by a corporation or any other person.

(c) *Other income and gains—*(1) *Items subject to tax.* The tax of 30 percent imposed by section 881 (a) also applies to the following gains received during the taxable year from sources within the United States:

(1) Gains described in section 631 (b) or (c), relating to the treatment of gain on the disposal of timber, coal, or iron ore with a retained economic interest;



(ii) In the case of—

(A) Bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which, by applying the principles of section 1232(a)(2)(B), are considered as gain from the sale or exchange of property which is not a capital asset and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which, by applying the principles of section 1232(a)(2)(B), would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact the obligations were issued after May 27, 1969,

(B) Bonds or other evidences of indebtedness issued after March 31, 1972, which are payable more than 6 months from the date of original issue (without regard to the period held by the taxpayer), amounts which, by applying the principles of section 1232(a)(2)(B), are considered as gain from the sale or exchange of property which is not a capital asset and, in the case of corporate obligations, amounts which, by applying the principles of section 1232(a)(2)(B), would be considered as gain from the sale or exchange of property which is not a capital asset but for the fact such obligations were issued after May 27, 1969, and

(C) The payment of interest on an obligation described in paragraph (c)(1)(ii)(B) of this section, an amount equal to the original issue discount accrued on such obligation since the last payment of interest thereon, except that the tax imposed by reason of this paragraph (c)(1)(ii)(C) may not exceed the amount of such interest payment less the tax imposed thereon under the rules of paragraph (b) of this section; and

(iii) Gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas,

good will, trademarks, trade brands, franchises, or other like property, or of any interest in any such property, to the extent the gains are from payments (whether in a lump sum or in installments) which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated under section 871(e) and § 1.871-11 as being so contingent.

(2) *Determination of amount of gain.* The tax of 30 percent imposed upon the gains described in paragraph (c)(1) of this section applies to the full amount of the gains and is determined (i) without regard to the alternative tax imposed by section 1201 (a) upon the excess of the net long-term capital gain over the net short-term capital loss; (ii) without regard to section 1231, relating to property used in the trade or business and involuntary conversions; and (iii) whether or not any property from which the gains are derived is a capital asset in the hands of the taxpayer.

(3) *Special rules applicable to original issue discount.* For special rules and examples to be applied for purposes of determining the 30-percent tax on amounts described in section 881(a)(3) and paragraph (c)(1)(ii) of this section, see paragraph (c)(4) of § 1.871-7.

• • • • •

PAR. 6. Section 1.1441 is amended by revising so much of section 1441 (b) as immediately precedes paragraph (1) thereof, by adding a new paragraph (8) to section 1441 (c), and by revising the historical note, as follows:

§ 1.1441 Statutory provisions; withholding of tax on non-resident aliens.

SEC. 1441. *Withholding of tax on nonresident aliens.*\*\*\*

(b) *Income items.* The items of income referred to in subsection (a) are interest (other than original issue discount as defined in section 1232(b)), dividends, rent, sala-



ries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), amounts subject to tax under section 871(a)(1)(C), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966. The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 14 percent are—

• • • • •

(c) *Exceptions.* • • •

(8) *Original issue discount.* The Secretary or his delegate may prescribe such regulations as may be necessary for the deduction and withholding of the tax on original issue discount subject to tax under section 871 (a)(1)(C) including rules for the reduction and withholding of the tax on original issue discount from payments of interest.

• • • • •

[Sec. 1441 as amended by sec. 544 (f), Mutual Security Act 1954 (added by sec. 11(a), Mutual Security Act 1956 (70 Stat. 563)); sec. 40(b), Technical Amendments Act 1958 (72 Stat. 1638); sec. 110(d), Mutual Educational and Cultural Exchange Act 1961 (75 Stat. 536); sec. 302(c), Rev. Act 1964 (78 Stat. 146); sec. 103(h), Foreign Investors Tax Act 1966 (80 Stat. 1553); sec. 505(b), Tax Reform Act 1969 (83 Stat. 634); sec. 313 (a) and (d), Rev. Act 1971 (85 Stat. 526). (Sec. 544(f), Mutual Security Act 1954, was repealed by sec. 11(b)(1), Mutual Security Act 1957 (71 Stat. 365), with the proviso that sec. 1441 was not affected by the repeal.)]

PAR. 7. Section 1.1441-2 is amended by revising paragraph (a)(1) and by adding a new paragraph (b)(2) (ii), as follows:

§ 1.1441-2 *Income subject to withholding.*

(a) *Fixed or determinable annual or periodical income.*

(1) The gross amount of fixed or determinable annual or periodical income is subject to withholding. Section 1441 (b) specifically includes in such income interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments; but other kinds of income are included, as, for instance, royalties. For purposes of the preceding sentence, the term "interest" includes interest on certain deferred payments, as provided in section 483 and the regulations thereunder. Effective with respect to payments occurring after March 31, 1972, the term "interest", as used in section 1441(b) and this paragraph (a)(1), does not include any original issue discount on any bond, debenture, note, certificate, or other evidence of indebtedness, as described in § 1.871-7(b)(2). The term "fixed or determinable annual or periodical" income is merely descriptive of the character of a class of income. If an item of income falls within the class of income contemplated by the statute, it is immaterial whether payment of that item is made in a series of payments or in a single lump sum. Thus, for example, \$5,000 in royalty income would come within the meaning of the term, whether paid in 10 payments of \$500 each or in one payment of \$5,000.

• • • • •

(b) *Other income subject to withholding.* • • •

(2) *Payments in taxable years of recipients beginning after December 31, 1966.* • • •

(ii) Amounts subject to the 30-percent tax under section 871(a)(1)(C) and § 1.871-7(c)(1)(ii), or section 881(a)(3) and § 1.881-2(c)(1)(ii), relating to—

(A) Gains realized on the sale, exchange, or retirement of certain bonds or other evidences of indebtedness which are issued after September 28, 1965, and

(B) Original issue discount ratably accrued on certain interest-bearing bonds or other evidences of indebtedness which are issued after March 31, 1972, and are payable more than 6 months from the date of original issue, but only to the extent and in the manner provided by § 1.1441-3(c)(6);

. . . . .

PAR. 8. Section 1.1441-3 is amended by revising the caption of paragraph (c), by adding a new subparagraph (6) to paragraph (c), and by revising paragraph (e)(2), as follows:

**§ 1.1441-3 Exceptions and rules of special application.**

. . . . .

*(c) Interest and original issue discount. . . .*

(6) *Original issue discount*—(i) *In general.* (A) In the case of payments occurring before (the 31st day following publication of the Treasury decision), withholding is required under § 1.1441-1 by the original issuer of any bond or other evidence of indebtedness issued after September 28, 1965, and before April 1, 1972, upon any gain realized by the holder on the sale, exchange, or retirement of such bond or other indebtedness, whether or not interest-bearing, to the extent that such gain is subject to tax under section 871(a)(1)(C)(i) and § 1.871-7(c)(1)(ii)(A), or under section 881(a)(3)(A) and § 1.881-2(c)(1)(ii)(A),

(B) In the case of payments occurring after (the 30th day following publication of the Treasury decision), withholding is required under § 1.1441-1 by a United States person upon any gain realized by the holder on the sale, exchange, or retirement of any bond or other evidence of

indebtedness, whether or not interest-bearing, issued after September 28, 1965, and before April 1, 1972, to the extent that such gain is subject to tax under section 871(a)(1)(C)(i) and § 1.871-7(c)(1)(ii)(A), or under section 881(a)(3)(A) and § 1.881-2(c)(1)(ii)(A),

(C) In the case of payments occurring after March 31, 1972, withholding is required under § 1.1441-1 by a United States person upon any gain realized by the holder on the sale, exchange, or retirement of any bond or other evidence of indebtedness, whether or not interest-bearing, issued after March 31, 1972, and payable more than 6 months from the date of original issue, to the extent that such gain is subject to tax under section 871(a)(1)(C)(ii) and § 1.871-7(c)(1)(ii)(B), or under section 881(a)(3)(B) and § 1.881-2(c)(1)(ii)(B), and

(D) In the case of payments occurring after March 31, 1972, withholding is required under § 1.1441-1 upon interest paid on any bond or other evidence of indebtedness issued after March 31, 1972, and payable more than 6 months from the date of original issue, to the extent that a tax may be withheld from such interest upon accrued original issue discount subject to tax under section 871(a)(1)(C)(iii) and § 1.871-7(c)(1)(ii)(C), or under section 881(a)(3)(C) and § 1.881-2(c)(1)(ii)(C).

(ii) *Evidences of indebtedness subject to withholding.* Withholding is required under paragraph (c)(6)(i) of this section on any bond, debenture, note, certificate, or other evidence of indebtedness taxable under section 871(a)(1)(C) and § 1.871-7(c)(1)(ii) and section 881(a)(3) and § 1.881-2(c)(1)(ii), except for payments occurring before (the 31st day following publication of the Treasury decision) on evidences of indebtedness issued by a person other than a government or political subdivision thereof, or by a corporation. Withholding is required under paragraph



(c)(6)(i) of this section on any bond, debenture, note, certificate, or other evidence of indebtedness issued by a person other than a government or political subdivision thereof, or by a corporation only with respect to payments occurring after (the 30th day following publication of the Treasury decision). Thus, withholding is required in all cases whether the evidence of indebtedness is a capital asset in the hands of the taxpayer within the meaning of section 1221 or whether it was held by the taxpayer more than 6 months, and withholding is also required with respect to payments occurring after (the 30th day following publication of the Treasury decision) whether the evidence of indebtedness was issued by a government or political subdivision thereof, or by a corporation or any other person.

(iii) *Statement by bond holder.* In the case of an amount described in paragraph (c)(6)(i) of this section, if the withholding agent does not know the amount subject to tax under section 871 (a)(1)(C) or 881 (a)(3), or the amount of tax under such section, he is required to deduct and withhold such amount as may be necessary to assure that the tax withheld will not be less than the tax imposed under such section. The withholding agent may, unless he has reason to believe to the contrary, rely on the statement of the person entitled to the income as to the amount which is subject to withholding or as to the amount of tax required to be withheld. The statement of such person must be filed with the withholding agent in duplicate and must show the name, address, and identifying number, if any, of the taxpayer, and contain a computation, in accordance with § 1.871-7(c)(4), of the amount of tax imposed under section 871 (a)(1)(C) or 881 (a)(3). The statement must be signed by the taxpayer with a written declaration that it is made under the penalties of perjury. No particular form is prescribed for this statement. The duplicate copy of each statement filed during any calendar year pursuant to this

paragraph (c)(6)(ii) must be forwarded by the withholding agent with, and attached to, the Forms 1042S required by paragraph (c) of § 1.1461-2 with respect to such amount for such calendar year. Appropriate adjustment, if any, will be made by the payee's filing of a claim for refund, together with appropriate supporting evidence, in accordance with paragraph (h) of this section.

(iv) *Definition of United States person.* The term "United States person", as used in this paragraph (c)(6), has the meaning assigned to it by section 7701(a)(30) except that it also includes any withholding agent (within the meaning of section 1465 and the regulations thereunder) required to deduct and withhold tax under chapter 3 upon interest on any obligation of the United States, a State or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government.

• • • • •

(e) *Personal exemption.* • • •

(2) (i) In the determination of the tax to be withheld at the source under § 1.1441-1 from remuneration paid for labor or personal services performed within the United States by a nonresident alien individual, the benefit of the deduction for personal exemptions provided in section 151, to the extent allowable under section 873(b)(3) and the regulations thereunder, shall be allowed, prorated upon a daily basis for the period during which labor or personal services are performed within the United States by the alien individual. The benefit of the deduction for such personal exemptions shall also be allowed in the determination of the tax of 14 percent to be withheld at the source under § 1.1441-1 and paragraph (c) of § 1.1441-2 from amounts paid after March 4, 1964, to nonresident alien individuals who are temporarily present in the United States as non-



immigrants under subparagraph (F) (relating to the admission of students into the United States) or subparagraph (J) (relating to the admission of teachers, trainees, specialists, etc., into the United States) of section 101(a)(15) of the Immigration and Nationality Act, as amended, 8 U.S.C. 1101(a)(15) (F) or (J), and such personal exemptions shall be prorated upon a daily basis for the period during which the described nonresident alien student or scholar receives the payments. In the case of taxable years beginning before January 1, 1970, the proration is on a basis of \$1.70 per day for each exemption to which the nonresident alien individual is entitled. In the case of taxable years beginning after December 31, 1969, the proration of one personal exemption on a daily basis shall be the amount of the personal exemption provided in section 151 for the taxpayer's taxable year divided by 360.

(ii) Thus, if A, a married nonresident alien individual without dependents is paid remuneration in 1966 subject to withholding under § 1.1441-1 for performing personal services during a stay of 100 days in the United States in such year, the amount of \$170 will be allocated as the portion of the deduction to be allowed against the remuneration for personal services performed within the United States during that period; and withholding at 30 percent shall be applied against the balance, if any, of the remuneration. If, for example, the total remuneration paid to A for that period is \$2,000, a total tax in the amount of \$549 ( $[\$2,000 - \$170] \times 0.30$ ) is required to be withheld under § 1.1441-1. However, if A is a resident of Canada or Mexico, and his spouse has no gross income which is subject to income tax under chapter 1 of the Code, and is not the dependent of another taxpayer subject to such tax, an amount of \$340 will be allocated as the portion of the deduction to be allowed against the remuneration for personal services performed

within the United States. Thus, in such case, a total tax in the amount of \$498 ( $[\$2,000 - \$340] \times 0.30$ ) is required to be withheld under § 1.1441-1.

(iii) As to what constitutes remuneration for labor or personal services performed within the United States see section 861(a)(3) and the regulations thereunder.

\* \* \*

PAR. 9. Section 1.1442 is amended by revising section 1442 (a) and the historical note to read as follows:

**§ 1.1442 Statutory provisions; withholding of tax on foreign corporations.**

SEC. 1442. *Withholding of tax on foreign corporations—*  
 (a) *General rule.* In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof, except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1) (C) and (D) shall be treated as referring to sections 881(a) (3) and (4), the reference in section 1441(c) (1) to section 871(b)(2) shall be treated as referring to section 842 or section 882(a)(2), as the case may be, the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881(a)(4), and the reference in section 1441(c)(8) to section 871(a)(1)(C) shall be treated as referring to section 881(a)(3).

\* \* \*

[Sec. 1442 as amended by sec. 104(c), Foreign Investors Tax Act 1966 (80 Stat. 1557); sec. 313(e), Rev. Act 1971 (85 Stat. 528)]